

Corporate Insolvency explained

Given the current economic climate, the threat of insolvency is unfortunately a subject that is becoming all too familiar to many businesses, both small and large. With luck your business will never be affected, however it is as well to have some grasp of the basics. Not only will this give you some awareness of the process should the worst happen, but it may also help your organisation to avoid becoming a victim. By recognising the signs in advance and then working around them using the processes available, insolvency need not be inevitable.

We make no apologies that this article is pitched at the basic level, as in our experience, people only start to grasp the concepts once it's too late, so a back-to-basics approach is required.

Your options

When a company finds itself in difficulty there are usually three options, the third of which we will concentrate on as it is often the most favoured route:-

1) Liquidate immediately – this can either be a voluntary arrangement by the shareholders or may be a compulsory winding up by your creditors.

2) Return to profitable trading through an arrangement with creditors – you may reach an informal agreement with your creditors, or there is also the more formalised Company Voluntary Arrangement (CVA). This is however quite administratively onerous and costly and is most appropriate for businesses with substantial debts.

3) Bring in an Administrator as an “external manager” – an Administrator can either be appointed by the court or by the company if the company is not already in liquidation. When appointed, they must act in accordance with the following objectives:-

- To try to rescue the company as a going concern
- To achieve a better result for the company's creditors than if the company were liquidated
- To realise any property (think tangible assets not just buildings) in order to make a distribution to secured or preferential creditors, whilst reducing where possible any harm to the company's creditors as a whole

If the company's problems are short term and can be solved with the support of the bank and possibly creditors, then rescuing the company may be possible. However, if this is not the case, then the time and expense of turning the business round may be prohibitive, especially where a “quick” sale as a going concern may be a better prospect.

When an Administrator is appointed, subject to a couple of points, this also has the affect of placing a moratorium over the commencement or continuation of proceedings against the company without the consent of the Administrator, so it provides a useful extra “shield”.

The Administrator develops proposals for achieving his priorities and presents them to the shareholders and creditors for consideration and to see whether they will be approved. If they are, then with a bit of luck the business can continue to move forward and flourish. Beware however, if the proposals are not accepted, then the court has discretionary powers including the power to make a winding-up order

Consequences for Directors

It is also important to note that the liquidation itself may not be the final issue as far as the directors are concerned. There are a number of circumstances where a director can incur personal liability as a result of their behaviour in the period before the insolvency occurred:-

Wrongful trading – if the director knew or ought to have concluded that there was no reasonable prospect of the company avoiding insolvent liquidation and they failed to take every step possible to minimise the potential loss to the company's creditors

Fraudulent trading – where it can be shown that the business of the company was carried on with an intent to defraud creditors. Basically, where the directors knew full well that the creditors would not be paid.

Risk of Disqualification – where the conduct of the director is such that the court regards him as unfit to be involved in the management of a company

Claw-back claims – for example where an under-value transaction has been made by the company within 2 years prior to the onset of insolvency, unless the transaction was entered into in good faith for the benefit of the company.

The conclusion here being, for all directors to act in good faith at all times and not to ignore or try to hide the threat of insolvency from the shareholders until it is too late.

Help is available

This is an unashamedly whistle-stop tour through the process of corporate insolvency. It provides you with some very basic background for the processes and their application. It may never apply to your business, but hopefully this article will leave you with two very clear messages. If liquidation is a genuine possibility, don't wait until it's too late, seek professional advice early and secondly, don't try to work around the system. The courts have seen it all before and the long term consequences can be severe!

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